



Financial Statements
June 30, 2019

South Dakota Retirement System,
South Dakota Retirement System
Supplemental Retirement Plan, and
South Dakota Retirement System
Special Pay Plan

**SOUTH DAKOTA RETIREMENT SYSTEM,
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN,
SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN**

Table of Contents

South Dakota Retirement System

Independent Auditor's Report	1
Management's Discussion and Analysis	4
Financial Statements	
Statement of Fiduciary Net Position	8
Statement of Changes in Fiduciary Net Position	9
Notes to Financial Statements	10
Required Supplementary Information	
Schedule of Changes in the System's Net Pension Liability	32
Schedule of System's Net Pension Liability (Asset)	33
Schedule of System's Contributions	33
Schedule of Investment Returns	34
Notes to Schedules of Required Supplementary Information	35
Other Supplementary Information	
Schedule of Administrative Expenses	36
Schedule of Investment Activity Expenses	37
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	38
<u>South Dakota Retirement System Supplemental Retirement Plan</u>	
Independent Auditor's Report	40
Management's Discussion and Analysis	42
Financial Statements	
Statement of Fiduciary Net Position	46
Statement of Changes in Fiduciary Net Position	47
Notes to Financial Statements	48
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	55
<u>South Dakota Retirement System Special Pay Plan</u>	
Independent Auditor's Report	57
Management's Discussion and Analysis	59
Financial Statements	
Statement of Fiduciary Net Position	63
Statement of Changes in Fiduciary Net Position	64
Notes to Financial Statements	65
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	70



Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System (SDRS), which comprise the statement of fiduciary net position as of June 30, 2019, and the related statement of changes in fiduciary net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of the fiduciary net position of the South Dakota Retirement System, as of June 30, 2019, and the respective statement of changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 2 to the financial statements, the financial statements include investments valued at \$2,257,030,399 (18.10 percent of net position) whose carrying values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters**Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the required supplementary information on pages 4-7 and 32-35 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise SDRS's basic financial statements as a whole.

The additional supplementary information listed as other supplementary information in the table of contents are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying financial information listed as supplemental schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2019 on our consideration of SDRS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SDRS's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SDRS's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Boise, Idaho
November 6, 2019

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2019

This section presents management's discussion and analysis of the South Dakota Retirement System's (SDRS or the System) financial position and performance as of and for the year ended June 30, 2019. This section is intended to supplement the SDRS financial statements and should be read in conjunction with the remainder of the SDRS financial statements.

Financial Highlights

- The fiduciary net position of SDRS increased by \$237 million during fiscal year 2019. This increase was primarily due to the investment performance of 4.87 percent, which was below the assumed rate of 6.50 percent.
- SDRS paid \$572 million to SDRS benefit recipients in fiscal year 2019 compared to \$542 million in 2018.
- SDRS received \$255 million in SDRS member and employer contributions in fiscal year 2019 compared to \$249 million in 2018.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The System presents the statement of the fiduciary net position as of June 30, 2019, and the statement of changes in fiduciary net position for the year then ended. These statements reflect resources available for the payment of benefits as of the year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules. Information in the notes provides disclosures concerning SDRS's organization, contributions and reserves, investments, the use of derivatives and securities lending, and other information.

Supplemental Information

In addition to this discussion and analysis, the required supplemental information consists of four schedules of trend data and related notes concerning the funded status of SDRS, changes in net pension liability (asset), investment returns, actuarial assumptions, and employer contributions.

Other supplementary schedules include detailed information on administrative expenses incurred by SDRS and a breakout of investment manager fees.

Financial Analysis

SDRS is a cost-sharing, multiple-employer public employee retirement system. SDRS provides retirement, disability, and survivor benefits for employees of the state of South Dakota and its political subdivisions. The benefits are funded through member and employer contributions and investment income.

SDRS benefits are based on the members' final average compensation, their years of credited service, and a benefit multiplier.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2019

A summary of the fiduciary net position is shown below:

Summary of Fiduciary Net Position

June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Assets:		
Cash and cash equivalents	\$ 7,488,388	\$ 6,485,922
Receivables	384,345,349	50,412,410
Investments, at fair value	12,344,910,568	12,197,453,935
Other assets	1,470,817	1,728,700
Total assets	<u>12,738,215,122</u>	<u>12,256,080,967</u>
Liabilities:		
Accounts payable and accrued expenses	2,115,371	1,872,698
Unsettled investment purchases	263,300,094	18,489,014
Total liabilities	<u>265,415,465</u>	<u>20,361,712</u>
Net position restricted for pension benefits	<u>\$ 12,472,799,657</u>	<u>\$ 12,235,719,255</u>

Change in Fiduciary Net Position

Additions to the fiduciary net position include member and employer contributions and net investment income. The fixed member and employer contribution rates are established by law. On an annual basis, an actuarial valuation of SDRS is made to determine the adequacy of the fixed contribution rates to pay the normal cost of benefits, expenses, and amortize the unfunded actuarial accrued liability. In addition to the fixed contributions, members and employers may make additional contributions to purchase uncredited prior service. These purchase or acquisition payments are also included as contributions.

Income from investments is the other primary source of revenue for SDRS. The actuarial assumed investment rate was 6.5 percent at June 30, 2019. The net investment returns were 4.9 percent for 2019 and 7.9 percent for 2018.

Deductions from fiduciary net position are primarily benefit payments. During 2019, SDRS paid \$572 million to benefit recipients or 5.5 percent more than 2018. The increase is due to the annual cost-of-living adjustment, which was 1.89 percent for fiscal year 2019, and additional annuitants. Refunds of accumulated contributions during 2019 increased 10.2 percent. Administrative costs of SDRS increased 4.6 percent during 2019.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2019

A summary of the changes in fiduciary net position is shown below:

Summary of Changes in Fiduciary Net Position

	<u>2019</u>	<u>2018</u>	<u>Percentage change</u>
Additions:			
Employee contributions	\$ 127,454,956	\$ 124,262,387	2.6%
Employer contributions	127,572,348	124,734,270	2.3%
Investment income	<u>583,573,718</u>	<u>911,695,475</u>	<u>-36.0%</u>
Total additions	<u>838,601,022</u>	<u>1,160,692,132</u>	<u>-27.7%</u>
Deductions:			
Benefits	572,351,398	542,300,333	5.5%
Refunds of contributions	24,073,325	21,840,814	10.2%
Administrative expenses	<u>5,095,897</u>	<u>4,870,334</u>	<u>4.6%</u>
Total deductions	<u>601,520,620</u>	<u>569,011,481</u>	<u>5.7%</u>
Net change in net position	237,080,402	591,680,651	-59.9%
Plan net position restricted for pension benefits:			
Beginning of year	<u>12,235,719,255</u>	<u>11,644,038,604</u>	<u>5.1%</u>
End of year	<u>\$ 12,472,799,657</u>	<u>\$ 12,235,719,255</u>	<u>1.9%</u>

Investments

SDRS investment portfolio management is the statutory responsibility of the South Dakota Investment Council. The South Dakota Investment Office is the primary investment manager, but the Investment Council may utilize the services of external money managers.

Net investment performance during 2019 and 2018 was 4.9 percent and 7.9 percent, respectively.

The Investment Council is governed by the prudent-man standard, as defined in South Dakota Codified Law §4-5-27:

§4-5-27. Prudent-man standard required in investments. Any investments under the provisions of §4-5-12 to §4-5-39, inclusive, shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

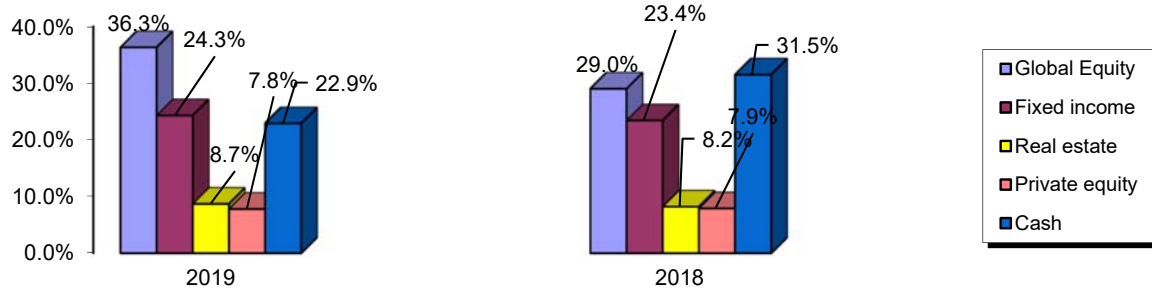
Though monthly benefit payments exceed monthly contributions, SDRS is not subject to sudden, substantial, and unexpected withdrawals. As a result, it is not necessary to maintain a high percentage of assets in short-term investments unless that is deemed to be the best investment strategy. This allows the SDRS trust fund to be fully invested in a diversified portfolio of securities.

SOUTH DAKOTA RETIREMENT SYSTEM

Management's Discussion and Analysis

June 30, 2019

Investment Summary



Plan Status

While the markets have not always made it possible to achieve the long-term assumptions, the System's funding remains solid.

Requests for Information

Requests for information about SDRS may be directed to the South Dakota Retirement System at P.O. Box 1098, Pierre, SD 57501. You may also contact SDRS online at www.sdrs.sd.gov.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Fiduciary Net Position

June 30, 2019

Assets	
Cash and cash equivalents	\$ 7,488,388
Receivables	
Employer	2,780,514
Employee	3,050,929
Benefits	78,693
Unsettled investment sales	340,572,887
Accrued interest and dividends	37,862,326
Total receivables	<u>384,345,349</u>
Investments, at fair value	
Equities	5,934,121,234
Fixed income	4,352,120,698
Real estate	1,086,737,834
Private equity	971,930,802
Total investments, at fair value	<u>12,344,910,568</u>
Assets used in plan operations, at cost (net of accumulated depreciation of \$607,343)	<u>1,453,258</u>
Other assets	<u>17,559</u>
Total assets	<u>12,738,215,122</u>
Liabilities	
Accounts payable and accrued expenses	2,115,371
Unsettled investment purchases	<u>263,300,094</u>
Total liabilities	<u>265,415,465</u>
Net position restricted for pension benefits	<u>\$ 12,472,799,657</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Statement of Changes in Fiduciary Net Position

Year Ended June 30, 2019

Additions	
Contributions	
Employee	\$ 127,454,956
Employer	<u>127,572,348</u>
Total contributions	<u>255,027,304</u>
Investment Income	
From investing activities	
Net appreciation in fair value of investments	314,247,712
Interest	142,442,232
Dividends	132,255,600
Real estate	<u>44,797,745</u>
Investment activity income	633,743,289
Less investment activity expenses	<u>(50,977,774)</u>
Net investment activity income	<u>582,765,515</u>
From security lending activities	
Security lending income	1,154,528
Security lending expenses	<u>(346,325)</u>
	<u>808,203</u>
Total additions	<u>838,601,022</u>
Deductions	
Benefits	572,351,398
Refunds of contributions	24,073,325
Administrative expenses	<u>5,095,897</u>
Total deductions	<u>601,520,620</u>
Net change in net position	237,080,402
Net position restricted for pension benefits:	
Beginning of year	<u>12,235,719,255</u>
End of year	<u>\$ 12,472,799,657</u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(1) General Description of the System

The South Dakota Retirement System (SDRS or the System) is a cost sharing, multiple employer public employee retirement system (PERS) established to provide retirement benefits for employees of the state of South Dakota (the State) and its political subdivisions. Members of SDRS include full time employees of public schools, the State, the Board of Regents, city and county governments, and other public entities. Public schools, cities, and counties may choose not to include certain full time employees in the System.

SDRS is considered a part of the State financial reporting entity and is included in the State's financial report as a pension trust fund. Authority for establishing, administering, and amending plan provisions is found in South Dakota Codified Law (SDCL) 3-12C.

The South Dakota Retirement System Board of Trustees (the Board) is the governing authority of SDRS. The Board consists of 14 elected representatives from participating groups, two appointees of the governor, and an ex officio nonvoting representative of the South Dakota Investment Council. The elected representatives of the Board are two teacher members; two State employee members; a participating municipality member; a participating county member; a participating classified employee member; a current contributing Class B member other than a justice, judge, or magistrate judge; a county commissioner of a participating county; a school district board member, a justice, judge, or magistrate judge, an elected municipal official of a participating municipality; a retiree; and a faculty or administrative member employed by the Board of Regents. The two Governor's appointees consist of one head of a principal department established pursuant to SDCL 1-32-2, or one head of a bureau under the office of executive management and one individual from the private or public sector.

SDRS is a hybrid defined benefit plan designed with several defined contribution plan type provisions. The System includes three classes of members: Class A general members, Class B public safety and judicial members, and Class C Cement Plant Retirement Fund members. Members and their employers make matching contributions, which are defined in State statute. SDRS may expend up to 3 percent of the annual contributions for administrative expenses subject to approval by the executive and legislative branches of the State.

Members that were hired before July 1, 2017, are Foundation members. Class A Foundation members and Class B Foundation judicial members who retire after age 65 with three years of service are entitled to an unreduced annual retirement benefit. An unreduced annual retirement benefit is also available after age 55 for Class A Foundation members where the sum of age and credited service is equal to or greater than 85 or after age 55 for Class B Foundation judicial members where the sum of age and credited service is equal to or greater than 80. Class B Foundation public safety members can retire with an unreduced annual retirement benefit after age 55 with three years of contributory service. An unreduced annual retirement benefit is also available after age 45 for Class B Foundation public safety members where the sum of age and credited service is equal to or greater than 75. All retirement benefits that do not meet the above criteria may be payable at a reduced level. Class A and B eligible spouses of foundational members will receive a 60 percent joint survivor benefit when the member dies.

Members that were hired on/after July 1, 2017, are Generational members. Class A Generational members and Class B Generational judicial members who retire after age 67 with three years of contributory service are entitled to an unreduced annual retirement benefit. Class B Generational public safety members can

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

retire with an unreduced annual retirement benefit after age 57 with three years of contributory service. At retirement, married Generational members may elect a single-life benefit, a 60 percent joint and survivor benefit, or a 100 percent joint and survivor benefit. All Generational retirement benefits that do not meet the above criteria may be payable at a reduced level. Generational members will also have a variable retirement account (VRA) established, in which they will receive up to 1.5 percent of compensation funded by part of the employer contribution. VRAs will receive investment earnings based on investment returns.

Class C Cement Plant Retirement Fund members have a normal retirement age of 65 and early retirement is age 55 with the required credited service. Class C Cement Plant provides for disability payments for those disabled on or before March 16, 2001. All members of the Cement Plant Retirement Plan on March 15, 2001, were 100 percent vested. Class C members may elect a single-life benefit, or joint and survivor benefits as described in their plan documents.

Legislation enacted in 2017 established the current COLA process. At each valuation date:

- Baseline actuarial accrued liabilities will be calculated assuming the COLA is equal to the long-term inflation assumption of 2.25 percent.
- If the fair value of assets is greater or equal to the baseline actuarial accrued liabilities, the COLA will be:
 - * The increase in the 3rd quarter CPI-W, no less than 0.5 percent and no greater than 3.5 percent.
- If the fair value of assets is less than the baseline actuarial accrued liabilities, the COLA will be:
 - * The increase in the 3rd quarter CPI-W, no less than 0.5 percent and no greater than a restricted maximum such that, that if the restricted maximum is assumed for future COLAs, the fair value of assets will be greater or equal to the accrued liabilities.

All benefits except those depending on the Member's Accumulated Contributions are annually increased by the Cost-of-Living Adjustment.

SDRS is a qualified defined benefit retirement plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. SDRS last received a favorable determination letter dated October 3, 2016, in which the Internal Revenue Service stated that the System, as then designated, was in compliance with the applicable requirements of the Internal Revenue Code. SDRS believes that the system currently is designed and being operated in compliance with the applicable requirements of the Internal Revenue Code, and therefore, SDRS continues to be tax-exempt as of June 30, 2019. Therefore, no provision for income taxes has been included in SDRS's financial statements.

SDRS is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. SDRS participates in the various programs administered by the State. These risk management programs are funded through assessments charged to participating entities. The risk management programs include (1) coverage for risks associated with automobile liability and general tort liability (including public officials' errors and omissions liability, medical malpractice liability, law enforcement liability, and products liability) through the State's Public Entity Pool for Liability Fund, (2) coverage of employee medical claims through the State's health insurance program, (3) coverage for unemployment benefits through the State's Unemployment Insurance

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Fund, and (4) coverage for workers' compensation benefits through the State's Workers' Compensation Fund. Financial information relative to the self-insurance funds administered by the State is presented in the State of South Dakota Comprehensive Annual Financial Report.

As of June 30, 2019, the number of participating governmental employers is as follows:

School Districts	164
State of South Dakota	1
Board of Regents	1
Municipalities	167
Counties	65
Board and Commissions	99
	497
Total employers	497

At June 30, 2019, SDRS membership consists of the following:

Retirees and beneficiaries currently receiving benefits:	
Class A (general employees)	27,109
Class B (public safety and judicial employees)	1,848
Class C (cement plant employees)	239
	29,196
Total retirees and beneficiaries	
Terminated members entitled to benefits but not yet receiving them:	
Class A (general employees)	17,938
Class B (public safety and judicial employees)	1,017
Class C (cement plant employees)	34
	18,989
Total terminated members	
Current active members:	
Vested:	
Class A (general employees)	29,970
Class B (public safety and judicial employees)	2,334
Class C (cement plant employees)	13
Nonvested:	
Class A (general employees)	8,280
Class B (public safety and judicial employees)	903
	41,500
Total current active members	
Grand total	
89,685	

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

- * *There are 116 class A and 10 class B public safety and judicial members or beneficiaries whose benefits are currently suspended but are entitled to future benefits. These members or beneficiaries are included as retirees and beneficiaries in their respective classes as listed.*

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting and Presentation

The accompanying financial statements are prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles applicable to governmental accounting for a pension trust fund. Employee and employer contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Pension benefit payments are due the first day of the month following the retirement of a member, and the first of each month thereafter. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

(b) Method Used to Value Investments

Investments are reported at fair value, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 72. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 sets forth the framework for measuring value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. The three levels of the fair value hierarchy under GASB 72 are described as follows:

Level 1 – Valuation inputs are quoted prices in active markets for identical asset or liability as of the measurement date.

Level 2 – Valuation inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Valuation inputs are based on significant unobservable inputs for an asset or liability.

As a practical expedient, GASB 72 allows the net asset value (NAV) or its equivalent to be used when a readily determinable fair value is not available. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner and are excluded from the fair value hierarchy.

Additional required disclosures can be found in Note 5: Cash and Investments.

Investments denominated in foreign currencies are translated into United States Dollars (USD) using the year-end spot foreign currency exchange rates. Foreign exchange rate gains and losses are included with the net appreciation in fair value of investments.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Alternative investments consist of investments in a variety of markets and industries through partnerships, corporate entities, co-investments, and other investment vehicles. For alternative investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, values these investments in good faith based upon the investment's current financial statements or other information provided by the underlying investment advisor. For all of these alternative investments, SDRS has determined that net asset value reported by the underlying fund approximates the fair value of the investment. These fair value estimates are, by their nature, subjective and based on judgment. These alternative investments were valued at \$2,257,030,399 (18.10 percent of net position) at June 30, 2019. The estimated fair value of these investments may differ significantly from values that would have been used had a ready market existed.

Futures contracts are marked to market based on quoted futures prices with changes in fair value reflected in the current period.

Interest is accrued in the period in which it is earned and dividend income is recorded on the ex-dividend date.

The arithmetically calculated money-weighted return net of fees was 4.87 percent in 2019. The money-weighted rate of return considers the changing amounts actually invested during a period and weights the amount of pension plan investment by the proportion of time they are available to earn during that period. The rate of return equates the sum of weighted external cash flows into and out of pension plan investments to the ending fair value of the pension plan investment.

(c) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and changes therein. Actual results could differ from those estimates.

(3) Contributions and Reserves

(a) Contributions

Covered employees are required by statute to contribute a percentage of their salary to SDRS as follows:

Class A members	6.0% of salary
Class B public safety members	8.0% of salary
Class B judicial members	9.0% of salary

All participating employers are required to contribute an amount equal to the members' contributions. Members may make an additional contribution of 1.5 percent of compensation for optional spouse coverage (closed to new enrollees after July 1, 2010).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

SDRS is funded by fixed member and employer contributions at a rate established by South Dakota law. On an annual basis, an actuarial valuation of SDRS is performed to determine the adequacy of the fixed contributions to pay the normal costs and expenses, if the System is fully funded or pay the normal costs, expenses and amortize the unfunded actuarial accrued liability (UAAL) if the System is not fully funded. The June 30, 2019, actuarial valuation of the plan determined that the System is fully funded and that the statutorily required employer contributions meet the requirements for the annual required contributions of the employers under GASB Statement No. 67, *Financial Reporting for Pension Plans*; and the statutorily required employer contributions are sufficient to pay the employer normal cost and expenses. Annual required contributions of the employers equal to the statutorily required contributions have been listed below pursuant to GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*.

Contributions during fiscal year 2019 totaling \$255,027,304 (\$127,454,956 employee, \$127,572,348 employer) were made in accordance with statutory rates. The employer contributions exceed the employee contributions due to the effect of SDCL 3-12C-1405, which governs the contributions of retired members who enter covered employment. Contributions for the last 5 fiscal years are as follows:

	Employer	Percentage contributed
Year ending June 30:		
2019	\$ 127,572,348	100%
2018	124,734,270	100
2017	121,907,646	100
2016	114,090,075	100
2015	109,549,977	100

SDRS allows participating entities to pay their deferred contributions for funding of accrued benefits over periods of up to 20 years and members to pay for the purchase of certain prior service over periods of up to 10 years. Interest is charged at rates of 5 percent to 8 percent.

Future payments will be received as follows:

	Employees
Year ending June 30:	
2020	\$ 75,079
2021	55,694
2022	53,876
2023	27,891
2024	26,591
Later	76,163
Deferred contributions receivable at June 30, 2019	\$ 315,294

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(4) Net Pension Liability (Asset) of the System

The components of the net pension liability (asset) of the System at June 30, 2019, was as follows:

Total pension liability	\$12,462,202,396
Plan fiduciary net position	<u>(12,472,799,657)</u>
Net pension liability (asset)	<u>\$ (10,597,261)</u>

Fiduciary net position as a percentage of net pension liability	100.09%
-----------------------------------------------------------------	---------

Actuarial Assumptions – The total pension liability was determined by an actuarial valuation as of June 30, 2019, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.25%
Salary increases	6.50% at entry to 3.0% after 25 years of service
Discount Rate	6.50%, net of pension plan investment expenses
Future COLAS	1.88%

Mortality rates were based on 97 percent of the RP-2014 Mortality Table, adjusted to 2006 and projected generationally with Scale MP-2016, white collar rates for females and total dataset rates for males. Mortality rates for disabled members were based on the RP-2014 Disabled Mortality Table, adjusted to 2006 and projected generationally with Scale MP-2016.

The actuarial assumptions used in the June 30, 2019, valuation were based on the results of an actuarial experience study for the period of July 1, 2011, to June 30, 2016.

Discount rate – The discount rate used to measure the total pension liability was 6.50 percent. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that matching employer contributions will be made at rates equal to the member rate. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of (asset)/liability to changes in the discount rate – The following presents the net pension (asset)/liability of the System, calculated using the discount rate of 6.50 percent, as well as what the System’s net pension (asset) liability would be if it were calculated using a discount rate that is 1 percent point lower (5.50 percent) or 1 percent point higher (7.50 percent) than the current rate:

	<u>1 percent Decrease</u>	<u>Current Discount Rate</u>	<u>1 percent Increase</u>
System’s net pension (asset)/liability	\$ 1,758,938,029	\$(10,597,261)	\$ (1,452,448,776)

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(5) Cash and Investments

Cash and Deposits

Cash and cash equivalents are held by the State Treasurer and were invested in the State's pooled investment fund. Investments in the State's pooled investment fund consist primarily of short-term U.S. Treasury and Agency obligations, short-term U.S. Corporate securities, bank certificates of deposit, and money market funds.

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are held in the possession of an outside party. SDRS has a formal deposit policy specific to custodial credit risk and foreign currencies. Policy states that the USD equivalent of any non-USD currency cannot exceed 2.0 percent of any portfolio on a trade date +7 days basis. All portfolios as of June 30, 2019 meet policy guidelines. These deposits are not collateralized or covered by depository insurance. As a result, \$15,807,559 was exposed to custodial credit risk, which is recorded in investments in the statement of fiduciary net position.

Investments

Investment portfolio management is the statutory responsibility of the South Dakota Investment Council (SDIC), which may utilize the services of external money managers for management of a portion of the portfolio. SDIC is governed by the Prudent Man Rule (i.e., the council should use the same degree of care as a prudent man). Current SDIC investment policies dictate limits on the percentage of assets invested in various types of vehicles (equities, fixed income securities, real estate, cash, private equity, etc.). The long-term expected rate of return on pension plan investments was determined using a method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2019, (see the discussion of the pension plan's investment policy) are summarized in the following table using geometric means:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Global Equity	58 percent	4.7 percent
Fixed Income	30 percent	1.7 percent
Real Estate	10 percent	4.3 percent
Cash	<u>2 percent</u>	0.9 percent
	100 percent	

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Below is a detail of the investment balances and amounts managed by the respective fund managers:

	Cost	Fair value
State of South Dakota Investment Council	\$ 8,314,290,226	\$ 9,195,330,016
Apollo	-	47,772
Ares	5,158,014	2,775,743
Blackstone Private Equity	159,638,816	229,830,386
Blackstone Real Estate Partners	599,209,978	704,886,328
Brandes Global Mid-Cap	70,851	70,544
Bridgewater Pure Alpha Fund II	36,742,005	96,025,726
Brookfield Strategic RE III	20,020,131	21,378,452
Capital International	46,379,701	43,506,885
Cargill North American Real Estate Partners	-	19,443
Carlyle	90,743,798	98,626,435
Cinven	100,524,619	100,675,027
CVC	55,772,726	38,064,496
CVI Global Value Fund	27,247,784	7,077,318
Cypress Merchant Banking Partners LP	26,315	26,315
Dimensional Fund Advisors, Inc.	14,949,080	61,584,998
Doughty Hanson & Co European Real Estate	442,225	700,170
Doughty Hanson PE IV	3,806,350	1,812,554
Elevation Partners	288,267	96,628
Encap Energy	7,265,091	7,370,873
KKR Associates	834,840	533,049
Lone Star Real Estate	120,597,615	133,617,592
Pinebridge	5,322,335	3,319,317
Riverstone	171,086,438	144,083,623
Rockpoint RE IV	110,343,405	132,143,027
Sanders All Asset Value	28,909,856	33,673,721
Sanders Capital	48,793,402	58,813,615
Silver Lake Partners LP	198,068,302	303,985,214
Starwood RE IX	87,810,072	91,169,307
TCW Opp MBS Strategy	748,693,187	833,665,994
	\$ 11,003,035,428	\$ 12,344,910,568
Total		

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment grade fixed income portfolios of SDRS are benchmarked to the duration of the Citigroup Broad Investment Grade (BIG) Index and must fall between 70 percent and 130 percent of the BIGs duration.

The durations of the various investment types are listed in the following table:

	<u>Fair value</u>	<u>Duration (in years)</u>
Investment type:		
U.S. Treasuries	\$ 91,422,739	6.32
U.S. Treasury Bills	660,000,546	0.14
U.S. Treasury STRIPS	231,082,964	7.72
U.S. agencies	54,121,871	7.11
Investment grade corporates	385,260,318	4.51
High-yield corporates	466,509,007	2.96
Agency mortgage-backed securities	335,863,649	4.26
Non-agency mortgage-backed securities	793,174,355	0.74
Total	<u>\$ 3,017,435,449</u>	2.64

The SDRS fixed income portfolios invest in mortgage-backed securities. These securities are sensitive to prepayments by mortgagees, which is likely in declining interest rate environments, thereby reducing the value of these securities.

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SDRS. SDIC sets the investment policy annually for the SDRS. This policy establishes the average percentage invested in each asset category and the fund allocation range that each asset category can vary during the fiscal year. As of June 30, 2019, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

	<u>Fair value</u>
Moody's rating:	
Aaa	\$ 1,646,057,376
Aa	111,488,507
A	147,305,276
Baa	164,507,754
Ba	232,962,315
B	272,913,684
Caa	224,204,015
Ca	146,414,652
C	5,775,684
Unrated	306,524,002
Total	<u>\$ 3,258,153,265</u>

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may be attributed to the magnitude of SDRS's investment in a single issuer. SDRS does not have guidelines to limit its investments in any particular investment. SDRS does not have investments in any one issuer that represent 5 percent or more of the total fair value of investments as of June 30, 2019 (excluding those issued by or explicitly guaranteed by the U.S. government).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(d) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SDRS's exposure to foreign currency risk derives from its positions in foreign currency and foreign-currency-denominated equity and fixed income investments. SDRS does not hedge foreign currency back to U.S. dollars (to match the unhedged benchmark), but does allow hedging under certain circumstances, when deemed appropriate. The portfolio's exposure to foreign currency risk at June 30, 2019, is as follows (in U.S. dollar fair value):

	Equities	Cash	Total
Currency:			
Australian Dollar	\$ 24,403,142	\$ 177,356	\$ 24,580,498
Brazilian Real	-	5,295	5,295
British Pound	223,268,973	3,752,407	227,021,380
Canadian Dollar	87,371,947	431,899	87,803,846
Danish Kroner	15,135,274	-	15,135,274
Euro	358,514,753	9,444,248	367,959,001
Hong Kong Dollar	17,634,313	113,934	17,748,247
Japanese Yen	198,613,714	1,882,420	200,496,134
Korean Won	87,091,438	-	87,091,438
Norwegian Krone	1,750,479	-	1,750,479
Singapore Dollar	989,154	-	989,154
Swedish Krona	15,623,722	-	15,623,722
Swiss Franc	211,813,977	-	211,813,977
Thai Baht	1,155,764	-	1,155,764
Total fair value	\$ 1,243,366,650	\$ 15,807,559	\$ 1,259,174,209

Investments with limited partnerships and certain global equity investments with external managers, which are not included in the table above, may expose SDRS's portfolio to additional foreign currency risk. The total fair value of investments in real estate and private equity limited partnerships as of June 30, 2019, was \$2,058,668,636. The total fair value of global equity and high-yield fixed income investments managed by external managers was \$61,584,998 and \$7,077,318, respectively.

(e) Return on Investments

During fiscal year 2019, SDRS's investments (including investments bought and sold, as well as held during the year) appreciated in value by \$314,247,712.

The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior years and current year.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Change in Fair Value of Investments

Appreciation (Depreciation) in fair value of investments:	
Equities	\$ (372,591,838)
Fixed income	24,127,632
Real estate	16,802,500
Private equity	(66,449,748)
Change in accrued income	<u>5,707,235</u>
Total decrease in fair value	<u>(392,404,219)</u>
Realized gain (loss) on investments:	
Equities	408,625,814
Fixed income	20,383,524
Real estate	51,485,858
Private equity	<u>92,035,789</u>
Total net realized gains	<u>572,530,985</u>
Futures - change in unrealized gain (loss)	(68,748,296)
Futures - Realized gain (loss)	<u>202,869,242</u>
Net gain on futures	<u>134,120,946</u>
Net appreciation in investments	<u><u>\$ 314,247,712</u></u>

(f) *Securities Lending*

State statutes and SDRS policies permit the use of investments for securities lending transactions. These transactions involve the lending of corporate debt, foreign equity securities, and domestic equity securities to broker-dealers for collateral in the form of securities, with the simultaneous agreement to return the collateral for the same securities in the future. SDRS's securities custodian is an agent in lending securities and shall accept only U.S. government securities or its agencies as collateral for any loan or loaned securities. The collateral required must equal 102 percent of fair value plus accrued interest for corporate debt securities, 102 percent of fair value for U.S. equity securities, and 105 percent of fair value for foreign securities except in the case of loans of foreign securities, which are denominated and payable in U.S. dollars, in which event the collateral required is 102 percent of fair value. The earnings generated from the collateral investments result in the gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

The fair value of securities on loan as of June 30, 2019, was \$321,636,462 and the collateral held on the same date was \$328,610,125. SDRS has no credit risk exposure to borrowers because the amounts the SDRS owes the borrowers exceed the amounts the borrowers owe SDRS. The contract with the lending agent requires the agent to indemnify SDRS if the borrowers fail to return the loaned securities and the collateral is inadequate to replace the securities lent.

All securities loans can be terminated on demand by either SDRS or the borrower. SDRS does not have the ability to pledge or sell collateral securities unless the borrower defaults; therefore, no asset and corresponding liability for the collateral value of securities received has been established on the statement of fiduciary net position. Regarding restrictions on loans, the securities lending agreement does limit the total value of securities that can be out on loan on any given day.

(g) *Custodial Credit Risk*

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. SDRS securities lending policies are detailed in the preceding Securities Lending section. As of June 30, 2019, the SDRS does not have custodial credit risk with regard to the security lending collateral.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(h) Fair Value Measurements and Applications

The following table shows the fair value in accordance with the GASB hierarchy:

		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Investments by fair value level	06/30/19			
Fixed Income securities				
U.S. Treasuries	\$ 91,422,739	\$ -	\$ 91,422,739	\$ -
U.S. Treasury Bills	660,000,546	-	660,000,546	-
U.S. Treasury STRIPS	231,082,964	-	231,082,964	-
U.S. Agencies	54,121,871	-	54,121,871	-
Investment Grade Corporates	385,260,318	-	385,260,318	-
High Yield Corporates	466,509,007	-	466,509,007	-
Agency Mortgage-Backed Securities	335,863,649	-	335,863,649	-
Non-Agency Mortgage-Backed Securities	793,174,355	-	793,174,355	-
Total fixed income securities	3,017,435,449	-	3,017,435,449	-
Equity securities				
Domestic Stock	4,014,625,036	4,014,049,051	575,985	-
Depository Receipts	53,900,310	53,900,310	-	-
ETF - Exchange Traded Funds	425,657,798	425,657,798	-	-
International Stock	1,243,366,651	1,243,366,651	-	-
Stock Warrants	371,722	-	371,722	-
Total equity securities	5,737,921,517	5,736,973,810	947,707	-
Alternative investments				
Real Estate Funds	700,170	-	-	700,170
Total alternative investments	700,170	-	-	700,170
Total investments by fair value level	\$ 8,756,057,136	\$ 5,736,973,810	\$ 3,018,383,156	\$ 700,170
Investments measured at the net asset value (NAV)				
Short Term Investment Funds	1,321,673,819			
Emerging Markets Small Cap Equity Mutual Funds	61,584,998			
Alternative investments				
Multi Strategy Hedge Funds	129,699,447			
Real Estate Funds	1,086,037,664			
Private Equity Funds	971,930,802			
Other Funds	7,077,318			
Total Investments measured at the NAV	\$ 3,578,004,048			
Total Investments measured at the fair value	\$ 12,334,061,184			
Plus: Cash held by Fund Managers	15,752,838			
Less: G/L on FX Transactions	(826,992)			
Less: Accrued Monthly Interest	(4,076,462)			
	12,344,910,568			
Investment derivative instruments				
Foreign Exchange Forward Contracts (liability)	(800,553)	-	(800,553)	-
Total investment derivative instruments	\$ (800,553)	\$ -	\$ (800,553)	\$ -

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Equity securities classified in Level 1 of the fair value hierarchy are valued using quoted prices in active markets for identical securities as of the measurement date as issued by pricing vendors. Securities classified in Level 2 of the fair value hierarchy include valuations using quoted prices for a similar security in active markets, and valuations from various pricing vendors/brokers using observable inputs other than quoted prices for identical securities.

Debt securities classified in Level 2 of the fair value hierarchy are valued using observable inputs other than quoted prices for identical securities. The prices are determined by the use of matrix pricing techniques maintained by various pricing vendors/brokers for these securities. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

Real estate funds classified in Level 3 of the fair value hierarchy are real estate alternative investments that invest primarily in overseas commercial real estate. These are investments which quoted prices are not readily available and are valued at estimated values as determined by the General Partner (GP). Investments are valued by the GP using one or more valuation methodologies with reference to the International Private Equity and Venture Capital Valuation Guidelines. The estimated fair values are subjective and based on judgment.

SDRS holds shares or interest in investments where the fair value of the investments are measured on a recurring basis using net asset value per share (or its equivalent) of the investment as a practical expedient. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner.

Derivative instruments classified in Level 2 of the fair value hierarchy are valued using observable inputs other than quoted prices for identical securities. The foreign currency forward contract valuations are determined by interpolating FX rates for various settlement dates as of June 30, 2019.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

The valuation method for investments measured at the net asset value (NAV) per share (or its equivalent) is presented in the following table:

Investments Measured at the NAV

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Short-Term Investment Funds (a)	\$ 1,321,673,819		Daily	0 days
Emerging Markets Small Cap Equity Mutual Funds (b)	61,584,998		Daily	1 day
Alternative investments				
Multi Strategy Hedge Funds (c)	129,699,447		Monthly	5 -30 days
Real Estate Funds (d)	1,086,037,664	\$ 948,075,767		
Private Equity Funds (e)	971,930,802	531,578,748		
Other Funds (f)	<u>7,077,318</u>			
Investments measured at the net asset value (NAV)	<u>\$ 3,578,004,048</u>			
Real Estate Funds (Level 3)	<u>\$ 700,170</u>	\$ -		

(a) Short Term Investment Funds. This type includes investments in four open-end mutual funds that invest exclusively or primarily in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies and instrumentalities. The fair values of the investments in this type have been determined using the NAV per share of the investments.

(b) Emerging Markets Small Cap Equity Mutual Funds. This type includes one investment in an open-end mutual fund that emphasizes broad diversification and consistent exposure to emerging market small company stocks. The fair value of the investment in this type has been determined using the NAV per share of the investment.

(c) Multi-Strategy Hedge Funds. This type includes two investments in funds that may invest in a wide range of asset classes in order to meet fund objectives. The fair values of the investments in this type have been determined using the NAV per share of the investments.

(d) Real Estate Funds. This type includes 26 real estate funds that invest primarily in commercial real estate. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. These investments can never be redeemed from the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 20 years. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(e) Private Equity Funds. This type includes 36 private equity funds that invest primarily in leveraged buyouts. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. These investments can never be redeemed from the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 20 years. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

(f) Other Funds. This type includes two other alternative investments that invest primarily in a broad range of debt, debt-related, and/or real estate-related investments. The fair values of the investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital. This investment can never be redeemed from the funds. Distributions from the fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the fund will be liquidated over the next 5 years. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the portfolio's ownership interest in partners' capital.

(6) Derivatives

Derivatives are generally defined as contracts whose values depend on, or derive from, the value of an underlying asset, reference rate, or index. SDRS is exposed to various derivative products through the investment management of the SDIC and its external managers. All of SDRS's derivatives are classified as investment derivatives.

Futures Contracts

A futures contract is a contract to buy or sell units of an index or financial instrument at a specified future date at a price agreed upon when the contract is originated. The South Dakota Investment Council purchases and sells futures contracts as a means of adjusting the SDRS portfolio mix at a lower transaction cost than the transactions, which would otherwise occur in the underlying portfolios. During fiscal year ended June 30, 2019, S&P 500 futures and 10-year U.S. Treasury note futures were utilized. Upon entering into such a contract, SDRS pledges to the broker cash or U.S. government securities equal to the minimum initial margin requirement of the futures exchange. Additionally, SDRS receives or pays a daily variation margin, which is an amount of cash equal to the daily fluctuation in value of the contract. The change in fair value of the futures contracts is presented in the statement of changes in fiduciary net position as "Net appreciation in fair value of investments." The net change in fair value from futures contracts for fiscal year ended June 30, 2019 was \$134,120,946.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Futures contract positions at June 30, 2019 were as follows:

Description	Expiration date	Open position	Number of contracts	Notional Contract size	Fair value
U.S. Treasury note	September 2019	Long	4,325	100,000 par value 6%, 10-year U.S. Treasury note	\$ 553,464,844
S&P 500 Index	September 2019	Short	11,185		\$ (1,646,571,813)

Foreign Currency Forward Contracts

The SDIC enters into foreign exchange forward contracts for SDRS to manage foreign currency exposure, as permitted by portfolio policies. The fair values of the contracts are presented in the Statement of Fiduciary Net Position as Investments, at fair value – Equities. The change in fair value of the forward contracts is presented in the statement of changes in fiduciary net position as “Net appreciation in fair value of investments.” The net change in fair value from foreign currency forward contracts for fiscal year ended June 30, 2019 was \$420,894. At June 30, 2019, the foreign currency forward contracts outstanding were as follows:

Description	Notional amount	Currency	Value date	Fair value (US dollars)
Forward sale	\$ (20,770,519)	CHF	8/7/2019	\$ (800,553)

(a) Credit Risk

SDRS is exposed to credit risk on derivative instruments that are in asset positions. The SDIC attempts to minimize credit risk by entering into derivatives contracts with major financial institutions. At June 30, 2019, the net fair value of foreign currency forward contracts was \$0. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted.

(b) Foreign Currency Risk

SDRS is exposed to foreign currency risk on its foreign currency forward contracts because they are denominated in foreign currencies. The net fair value of the foreign currency forward contracts in U.S. dollars is \$(800,553).

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

(7) Compensated Absences

Annual leave is earned by all SDRS employees. Upon termination, SDRS employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2019, a liability existed for accumulated annual leave calculated at the employees' June 30, 2019 pay rate in the amount of \$189,711. Employees who have been continuously employed by SDRS and the State for at least seven years prior to the date of their retirement, voluntary resignation, or death will receive payment for one-fourth of their accumulated sick leave balance with such payment not to exceed the sum of 12 weeks of the employee's annual compensation. For employees who have not been employed for seven continuous years, an accrued liability is calculated assuming the likelihood that they will meet the seven-year threshold in the future. At June 30, 2019, a liability existed for accumulated and accrued sick leave calculated at the employees' June 30, 2019 pay rate in the amount of \$192,603.

	<u>2019</u>	<u>2018</u>	<u>Percentage change</u>
Total compensated absences	\$ 382,314	\$ 334,962	14.14%

The total leave liability for the current year is on the statement of fiduciary net position available for benefits in accounts payable and accrued expenses.

(8) Operating Leases

SDRS has entered into an agreement to lease office space effective September 2012 and has a term of ten years. A schedule of minimum office rental payments as of June 30, 2019, is as follows for the fiscal years ending June 30:

2020	\$ 112,279
2021	112,279
2022	<u>112,279</u>
Total remaining minimum payments	<u>\$ 336,837</u>

Lease expense for the year ending June 30, 2019 was \$112,279.

(9) Supplemental Retirement Plan

SDRS offers a deferred compensation plan known as the Supplemental Retirement Plan (SRP), created in accordance with Internal Revenue Code Section 457. SRP is available to all public employees and permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseen emergency.

All amounts of compensation deferred under the SRP, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are at all times held in trust for the exclusive benefit of the participants until made available to a participant or the participant's beneficiary.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

Of the \$413,824,990 net position restricted for plan benefits at June 30, 2019, \$247,992,462 was held in trust for employees of the State, while the remaining \$165,832,528 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$2,474,143 is included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2019.

(10) Special Pay Plan

The Special Pay Plan (SPP) was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the SDRS Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the plan. The SPP mandates that qualifying employees (over age 55 and \$600 or more in special pay) of participating units defer 100 percent of their special lump-sum termination pay to the plan. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

Of the \$60,872,370 net position restricted for plan benefits at June 30, 2019, \$33,148,491 was held in trust for employees of the State, while the remaining \$27,723,879 represents the assets held in trust for employees of other jurisdictions. In order to avoid duplication in reporting, the SDRS total of \$39,989 is included in the State total and the State's comprehensive annual financial report for the year ended June 30, 2019.

(11) Plan Termination

SDRS is administered in accordance with South Dakota statutes. The statutes provide for full vesting in accrued benefits upon termination of the plan (SDCL 3-12C-221).

(12) Commitments

At June 30, 2019, SDRS had uncalled capital commitments to private equity limited partnerships totaling approximately \$734,070,785 and to real estate limited partnerships totaling approximately \$1,577,675,767. The commitments may be called at the discretion of the general partner or may never be called.

(13) Litigation

Deutsche Bank and Wilmington Trust Company have filed a number of actions around the country against selling shareholders, and those actions are all now consolidated in a Multi District Panel proceeding in the Southern District of New York (In re: Tribune Company Fraudulent Conveyance Litigation, Case No. 11-MD-2296). A separate adversary proceeding which was pending in Delaware has been consolidated into this action as well (The Official Committee of Unsecured Creditors of Tribune Company, on behalf of Tribune Company v. Dennis J. FitzSimmons, et al., Case No. 1:12-cv-02652). SDRS is a defendant as a result of selling Tribune Stock in connection with a leveraged buyout of the Tribune Company in 2007. Through this lawsuit the creditors of Tribune Company are attempting to claw-back funds received in connection with the sale of the stock, which, in the case of SDRS, is approximately four million dollars. Claims against the former Tribune shareholders have been dismissed. The Noteholder litigation was dismissed in 2013 and affirmed by the Second Circuit. The Noteholders sought review by the U.S. Supreme Court and the Court has still not agreed to take it up.

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Financial Statements

June 30, 2019

The FitzSimmons litigation was dismissed in January 2017 and although the Plaintiff has now sought leave to amend the complaint, that request was previously rejected by the Court in February 2017. On July 12, 2019, the Plaintiff filed a notice of appeal. The pending legal action does not represent an immediate negative contingency.



Required Supplementary Information
June 30, 2019

South Dakota Retirement System

SOUTH DAKOTA RETIREMENT SYSTEM

Schedules of Required Supplementary Information

June 30, 2019

SCHEDULE OF CHANGES IN THE SYSTEM'S NET PENSION LIABILITY

Last Fiscal Year

	2019	2018	2017	2016	2015	2014
Total pension liability						
Service cost	\$ 233,802,396	\$ 222,709,592	\$ 192,682,191	\$ 184,923,317	\$ 179,349,820	\$ 161,697,696
Interest	791,288,656	752,702,794	781,413,919	745,774,586	712,632,857	633,951,211
Changes in benefit terms	-	-	(567,079,980)	-	-	(5,082,771)
Differences between expected and actual experience	(6,190,846)	5,220,615	97,593,700	78,645,840	55,821,847	78,328,269
Changes of assumptions	(193,660,111)	181,931,669	820,191,401	-	-	604,281,184
Cement plant consolidation	-	-	-	-	-	60,649,185
Benefit payments, including refunds	(596,424,723)	(564,141,147)	(541,090,032)	(510,496,482)	(482,494,871)	(450,490,712)
Net change in total pension liability	<u>228,815,372</u>	<u>598,423,523</u>	<u>783,711,199</u>	<u>498,847,261</u>	<u>465,309,653</u>	<u>1,083,334,062</u>
Total pension liability - beginning	<u>12,233,387,024</u>	<u>11,634,963,501</u>	<u>10,851,252,302</u>	<u>10,352,405,041</u>	<u>9,887,095,388</u>	<u>8,803,761,326</u>
Total pension liability - ending	<u><u>12,462,202,396</u></u>	<u><u>12,233,387,024</u></u>	<u><u>11,634,963,501</u></u>	<u><u>10,851,252,302</u></u>	<u><u>10,352,405,041</u></u>	<u><u>9,887,095,388</u></u>
Plan fiduciary net position						
Contributions - employer	127,572,348	124,734,270	121,907,646	114,090,075	109,549,977	104,952,985
Contributions - member	127,454,956	124,262,387	122,144,961	114,443,295	110,152,580	106,175,381
Net investment income	583,573,718	911,695,475	1,431,977,414	22,836,265	435,682,659	1,695,543,796
Benefit payments, including refunds	(596,424,723)	(564,141,147)	(541,090,032)	(510,496,482)	(482,494,871)	(450,490,712)
Administrative expense	(5,095,897)	(4,870,334)	(4,363,512)	(3,944,641)	(3,911,222)	(3,853,073)
Cement plant consolidation	-	-	-	-	-	69,519,407
Net change in plan fiduciary net position	<u>237,080,402</u>	<u>591,680,651</u>	<u>1,130,576,477</u>	<u>(263,071,488)</u>	<u>168,979,123</u>	<u>1,521,847,784</u>
Plan fiduciary net position - beginning	<u>12,235,719,255</u>	<u>11,644,038,604</u>	<u>10,513,462,127</u>	<u>10,776,533,615</u>	<u>10,607,554,492</u>	<u>9,085,706,708</u>
Plan fiduciary net position - ending	<u><u>\$ 12,472,799,657</u></u>	<u><u>\$ 12,235,719,255</u></u>	<u><u>\$ 11,644,038,604</u></u>	<u><u>\$ 10,513,462,127</u></u>	<u><u>\$ 10,776,533,615</u></u>	<u><u>\$ 10,607,554,492</u></u>

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, pension plans should present information for those years in which information is available.

See Notes to Schedules of Required Supplementary Information

SOUTH DAKOTA RETIREMENT SYSTEM

Schedules of Required Supplementary Information

June 30, 2019

	2019	2018	2017	2016	2015	2014
SCHEDULE OF SYSTEM'S NET PENSION LIABILITY (ASSET)						
Total pension liability	\$ 12,462,202,396	\$ 12,233,387,024	\$ 11,634,963,501	\$ 10,851,252,302	\$ 10,352,405,041	\$ 9,887,095,388
Plan fiduciary net position	12,472,799,657	12,235,719,255	11,644,038,604	10,513,462,127	10,776,533,615	10,607,554,492
System's net pension liability (asset)	<u>\$ (10,597,261)</u>	<u>\$ (2,332,231)</u>	<u>\$ (9,075,103)</u>	<u>\$ 337,790,175</u>	<u>\$ (424,128,574)</u>	<u>\$ (720,459,104)</u>
Plan fiduciary net position as a percentage of the						
Total pension liability	100.09%	100.02%	100.08%	96.89%	104.10%	107.29%
Actuarial projected covered payroll	\$ 2,048,204,895	\$ 2,001,885,527	\$ 1,954,735,217	\$ 1,829,641,009	\$ 1,758,315,755	\$ 1,685,627,785
System's net pension liability (asset) as a percentage of covered payroll						
	-0.517%	-0.117%	-0.464%	18.462%	-24.121%	-42.741%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, pension plans should present information for those years in which information is available.

SCHEDULE OF SYSTEM'S CONTRIBUTIONS

Last Fiscal Year

	2019	2018	2017	2016	2015	2014
Actuarially determined contribution	\$ 127,572,348	\$ 124,734,270	\$ 121,907,646	\$ 114,090,075	\$ 109,549,977	\$ 103,483,647
Contributions in relation to the actuarially determined contribution	127,572,348	124,734,270	121,907,646	114,090,075	109,549,977	104,952,985
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,469,338)</u>
Reported covered payroll	\$ 2,048,204,895	\$ 2,001,885,527	\$ 1,954,735,217	\$ 1,829,641,009	\$ 1,758,315,755	\$ 1,685,627,785
Contributions as a percentage of covered payroll	6.228%	6.231%	6.237%	6.236%	6.230%	6.226%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, pension plans should present information for those years in which information is available.

See Notes to Schedules of Required Supplementary Information

SOUTH DAKOTA RETIREMENT SYSTEM
Schedules of Required Supplementary Information

June 30, 2019

SCHEDULE OF INVESTMENT RETURNS

Last Fiscal Year

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Annual money-weighted rate or return, net of investment expenses	4.84%	7.95%	13.84%	0.21%	4.17%	18.91%	19.01%	1.37%	25.27%	18.20%
Annual time-weighted rate or return, net of investment expenses	4.88%	7.94%	13.81%	0.30%	4.18%	18.90%	19.02%	1.45%	25.18%	17.99%

See Notes to Schedules of Required Supplementary Information

SOUTH DAKOTA RETIREMENT SYSTEM

Notes to Schedules of Required Supplementary Information

June 30, 2019

Methods and assumptions used in calculations of actuarially determined contributions. The actuarially determined contribution rates in the schedule of System's contributions are calculated as of July 1, two years prior to the end of the fiscal year in which contributions are reported. The following actuarial methods and assumptions were used to determine contribution rates reported in that schedule:

Valuation date	June 30, 2019
Amortization method	Level percentage of pay
Actuarial cost method	Entry age normal
Remaining amortization period	0 Years
Asset valuation method	Effective with the June 30, 2017 valuation, the actuarial value of assets is equal to the fair value of assets.
Actuarial assumptions:	
Investment rate of return	6.50%
Projected salary increases	6.50% at entry to 3.00% after 25 years of service
Post-retirement mortality table:	
Active Members	97% of RP-2014, adjusted to 2006 and projected generationally with Scale MP-2016, white collar rates for females and total dataset rates for males
Healthy inactive members, retired members and beneficiaries:	97% of RP-2014, adjusted to 2006 and projected generationally with Scale MP-2016, white collar rates for females and total dataset rates for males
Disabled inactive and retired members:	RP-2014 Disabled Mortality Table, adjusted to 2006 and projected generationally with Scale MP-2016



Other Supplementary Information
June 30, 2019

South Dakota Retirement System

SOUTH DAKOTA RETIREMENT SYSTEM

Other Supplementary Information

Year Ended June 30, 2019

Schedule of Administrative Expenses

Personal services:	
Salary and per diem	\$ 2,007,883
Employee benefits	<u>531,037</u>
Total personal services	<u>2,538,920</u>
Operating expenses:	
Travel	<u>100,493</u>
Contractual services:	
Audit	123,740
Finance	2,445
Valuations	19,587
Special studies	95,031
Legal	29,046
Communications	65,434
Operations	<u>1,397,258</u>
Total contractual services	<u>1,732,541</u>
Supplies and materials	430,450
Capital assets	<u>293,493</u>
Total operating expenses	<u>2,556,977</u>
Total administrative expenses	<u><u>\$ 5,095,897</u></u>

SOUTH DAKOTA RETIREMENT SYSTEM

Other Supplementary Information

Year Ended June 30, 2019

Schedule of Investment Activity Expenses

Investment managers

State of South Dakota Investment Council	\$ 11,266,588
Blackstone Private Equity	3,063,733
Blackstone Real Estate Partners	5,982,270
Brandes Global Mid-Cap	582,578
Brookfield Real Estate	1,429,505
Capital International	667,845
Carlyle	359,899
CINVEN	2,517,788
CVC	2,199,630
Doughty Hanson & Co European Real Estate	(63,927)
Doughty Hanson PE	91,360
Elevation Partners	5,592
EnCap Energy	753,074
KKR Associates	11,356
Lone Star Real Estate	5,436,216
Riverstone	3,312,914
Rockpoint Real Estate	4,024,122
Sanders All Asset Value	407,021
Sanders Capital	335,528
Silver Lake Partners LP	2,702,182
Starwood Real Estate	1,914,677
TCW Opp MBS Strategy	3,977,823

Total investment activity expenses

\$ 50,977,774



**Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System (SDRS), as of and for the year ended June 30, 2019, and the related notes to the financial statements, and have issued our report thereon dated November 6, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SDRS’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SDRS’s internal control. Accordingly, we do not express an opinion on the effectiveness of the SDRS’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SDRS’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Boise, Idaho
November 6, 2019



Financial Statements
June 30, 2019

South Dakota Retirement System Supplemental Retirement Plan



Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System Supplemental Retirement Plan (the Plan), which comprise the statement of fiduciary net position as of June 30, 2019, and the related statement of changes in fiduciary net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of fiduciary net position of the South Dakota Retirement System Supplemental Retirement Plan, as of June 30, 2019, and the respective statement of changes in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 42-45 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2019, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Plan's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Plan's internal control over financial reporting and compliance.



Boise, Idaho
November 6, 2019

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2019

This section presents management's discussion and analysis of the South Dakota Retirement System Supplemental Retirement Plan's (SRP or the Plan) financial position and performance for the year ended June 30, 2019. This section is intended to supplement the SRP financial statements.

Financial Highlights

- * The net position available for plan benefits of the SRP increased by \$36 million during fiscal year 2019. This increase was primarily attributable to investment gains during the year and contributions outweighing distributions to participants.
- * The SRP paid \$17.7 million to benefit recipients in fiscal year 2019 compared to \$14.3 million in 2018. The SRP received \$31.3 million in contributions in fiscal year 2019 compared to \$28.4 million in 2018.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of fiduciary net position as of June 30, 2019, and the statement of changes in fiduciary net position for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SRP was established in accordance with Internal Revenue Code Section 457 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SRP benefits are based on the participant balances in the Plan.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2019

A summary of the net position held in trust for plan benefits is shown below:

Summary of Fiduciary Net Position

June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Assets:		
Investments, at fair value	\$ 412,808,395	\$ 376,128,769
Cash	160,144	131,754
Accounts receivable	356,533	344,108
Accrued interest	2,048	1,051
Contributions receivable	<u>536,450</u>	<u>1,256,478</u>
Total assets	413,863,570	377,862,160
Liabilities:		
Accounts payable	<u>38,580</u>	<u>17,695</u>
Net position held in trust for plan benefits	<u><u>\$ 413,824,990</u></u>	<u><u>\$ 377,844,465</u></u>

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2019

Change in Fiduciary Net Position

Additions to the net position include contributions and net investment income. Deductions from net position are primarily benefit payments. During 2019, SRP paid \$17.7 million to benefit recipients, or 24.46 percent more than 2018.

A summary of the changes in fiduciary net position is shown below:

	2019	2018	Percentage Change
Additions:			
Contributions-employee	\$ 31,331,349	\$ 28,395,206	10.34%
Investment income	22,449,955	26,037,283	-13.78%
Other income (loss)	12,425	26,076	-52.35%
Transfers from related plan	653,485	490,703	33.17%
Total additions	54,447,214	54,949,268	-0.91%
Deductions:			
Distributions to participants	17,748,612	14,260,537	24.46%
Administrative expenses	715,551	660,273	8.37%
Transfers to related plan	2,526	57	4331.58%
Total deductions	18,466,689	14,920,867	23.76%
Net change in net position	35,980,525	40,028,401	-10.11%
Plan net position held in trust for plan benefits:			
Beginning of year	377,844,465	337,816,064	11.85%
End of year	\$ 413,824,990	\$ 377,844,465	9.52%

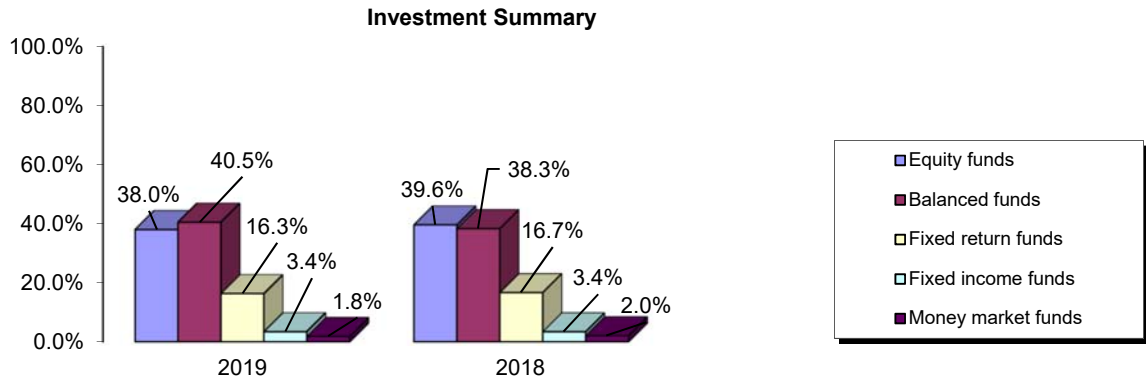
SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Management's Discussion and Analysis

June 30, 2019

Investments

The selection of SRP investment portfolio alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SRP fund types.



Requests for Information

Requests for information about the SRP may be directed to the Supplemental Retirement Plan at 222 East Capitol Ave, Suite 1, Pierre SD 57501. You may reach the SRP at (605) 224-2230, 1 (800) 959-4457, or online at www.srp457.com. You may link to the SRP Web site from the SDRS Web site at www.state.sd.us/sdrs/.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Statement of Fiduciary Net Position

June 30, 2019

Assets:

Investments, at fair value:

Equity funds	\$ 156,824,027
Balanced funds	167,075,374
Fixed return funds	67,292,986
Fixed income funds	14,014,913
Money market funds	<u>7,601,095</u>

Total investments, at fair value 412,808,395

Cash 160,144

Accounts receivable 356,533

Accrued interest 2,048

Contributions receivable 536,450

Total assets 413,863,570

Liabilities:

Accounts payable 38,580

Net position held in trust for plan benefits \$ 413,824,990

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Statement of Changes in Fiduciary Net Position

Year Ended June 30, 2019

Additions:	
Contributions-employee	\$ 31,331,349
Investment income	22,449,955
Other income	12,425
Transfers from related plan	<u>653,485</u>
Total additions	<u>54,447,214</u>
Deductions:	
Distributions to participants	17,748,612
Administrative expenses	715,551
Transfers to related plan	<u>2,526</u>
Total deductions	<u>18,466,689</u>
Net change in plan net position	35,980,525
Net position held in trust for plan benefits	
Beginning of year	<u>377,844,465</u>
End of year	<u><u>\$ 413,824,990</u></u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

(1) Plan Description

The following description of the South Dakota Retirement System Supplemental Retirement Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) *General*

The Plan was established in July 1987 in accordance with Internal Revenue Code Section 457 under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The state of South Dakota is a participating unit and every political subdivision thereof may become a participating unit in the Plan. The Plan consists of 25,606 participants and 346 employers. The Plan permits employees of participating units to defer a portion of their salary until future years. The deferred compensation is not available to the participants until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary, shall be held in trust for the exclusive benefit of the participant.

(b) *Contributions*

Participants of the Plan may contribute an amount of not less than \$25 per month and not in excess of \$18,500 for calendar year 2019 or 100 percent of includable compensation. A participant may make a one-time election to defer an additional amount of twice the otherwise applicable limit during any of the three calendar years immediately preceding a participant's elected normal retirement age. If age 50 or over, participants may also defer additional contributions of \$6,000.

There is a special catch-up provision that allows a participant for three years prior to the normal retirement age to contribute the lesser of:

- Twice the annual limit (\$38,000 in 2019) or
- The basic annual limit plus the amount of the basic limit not used in prior years (only allowed if not using age 50 or over catch-up contributions)

(c) *Participant's Account*

Each participant's account is credited with the participant's contributions, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) *Distribution to Participants*

Distributions of benefits to participants can be made upon termination, retirement, death, or unforeseeable emergency. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or installments, as defined in the plan agreement.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

(e) Vesting

Participants are vested immediately in their contributions plus actual earnings thereon.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) Investments

Investments are reported at fair value, in accordance with GASB Statement No. 72. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 sets forth the framework for measuring value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. The three levels of the fair value hierarchy under GASB 72 are described as follows:

Level 1 – Valuation inputs are quoted prices in active markets for identical asset or liability as of the measurement date.

Level 2 – Valuation inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Valuation inputs are based on significant unobservable inputs for an asset or liability.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

As a practical expedient, GASB 72 allows the net asset value (NAV) or its equivalent to be used when a readily determinable fair value is not available. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner and are excluded from the fair value hierarchy.

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mutual funds	\$ 331,500,496	\$ 331,500,496	\$ -	\$ -
Fixed income funds	81,307,899	14,014,913	-	67,292,986
Investments at fair value	\$ 412,808,395	\$ 345,515,409	\$ -	\$ 67,292,986

Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury Bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of United States and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20 percent of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

Investments denominated in foreign currencies are translated into USD using the year-end spot foreign currency exchange rates. Foreign exchange rate gains and losses are included with the net appreciation in fair value of investments.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

Changes in fiduciary net position for the year ended June 30, 2019 by investment alternatives available to participants were as follows:

	Beginning balance	Contributions	Investment Income	Transfers In/Out	Additions/ Deductions	Ending balance	Fair value as a percentage of plan assets
Money Market							
Vanguard Treasury Money Market	\$ -	\$ 630	\$ -	\$ -	\$ -	\$ 630	0.00%
Vanguard Prime Reserve	-	(350)	-	-	350	-	0.00%
Vanguard Federal Money Market	7,631,077	1,543,525	167,840	46,176	(1,788,153)	7,600,465	1.84%
	7,631,077	1,543,805	167,840	46,176	(1,787,803)	7,601,095	1.84%
Fixed Return:							
Prudential	62,658,110	2,699,158	1,927,524	179,725	(171,531)	67,292,986	16.26%
Fixed Income							
Vanguard Bond Market	12,657,983	743,947	995,415	31,831	(414,263)	14,014,913	3.39%
Balanced							
* Vanguard InstTrgRtrmInc Inst	9,716,460	63,351	587,740	-	(891,796)	9,475,755	2.29%
* Vanguard InstTrgRtrm2015 Inst	17,455,858	544,262	1,100,752	93,916	(1,507,007)	17,687,781	4.27%
* Vanguard InstTrgRtrm2020 Inst	30,542,742	2,981,821	2,095,782	21,989	(950,029)	34,692,305	8.38%
* Vanguard InstTrgRtrm2025 Inst	25,146,920	3,331,833	1,835,942	3,738	952,251	31,270,684	7.56%
* Vanguard Trgt Rtrmt 2025 Inv	-	-	191	-	(191)	-	0.00%
* Vanguard InstTrgRtrm2030 Inst	19,121,781	2,549,793	1,303,938	-	(1,072,408)	21,903,104	5.29%
* Vanguard InstTrgRtrm2035 Inst	10,899,117	1,759,543	781,241	-	(204,654)	13,235,247	3.20%
* Vanguard InstTrgRtrm2040 Inst	8,950,334	1,815,623	611,496	-	(684,122)	10,693,331	2.58%
* Vanguard InstTrgRtrm2045 Inst	8,794,627	1,944,057	610,562	-	(415,971)	10,933,275	2.64%
* Vanguard InstTrgRtrm2050 Inst	8,888,713	2,333,217	597,524	-	(1,249,621)	10,569,833	2.55%
* Vanguard InstTrgRtrm2055 Inst	3,800,439	1,248,124	283,838	-	(143,419)	5,188,982	1.25%
* Vanguard InstTrgRtrm2060 Inst	904,108	394,688	75,012	-904	(10,878)	1,362,930	0.33%
* Vanguard InstTrgRtrm2065 Inst	1,096	39,427	4,079	-	17,545	62,147	0.02%
* Vanguard Trgt Rtrmt Income	-	350	157	-	(507)	-	0.00%
Total Balanced	144,222,195	19,006,089	9,888,254	119,643	(6,160,807)	167,075,374	40.37%
Equity							
* Franklin Mutual Shares	15,485,938	157,076	(978,558)	7,521	(14,671,977)	-	0.00%
* Vanguard Growth Indx Adml	-	52,147	12,855	-	241,367	306,369	0.07%
* Vanguard Value Indx Adml	-	8,135	12,780	-	159,984	180,899	0.04%
* Windsor II Admiral	28,877,307	767,941	1,990,980	7,572	(1,962,893)	29,680,907	7.17%
* Vanguard Instit Index	39,970,391	1,587,822	6,222,356	126,460	8,660,104	56,567,133	13.67%
* Vanguard Tot Intl Stock Ind	8,957,014	505,164	67,412	15,211	(317,850)	9,226,951	2.23%
* Dodge Cox Global Stock	2,651,111	233,674	(10,553)	-	(161,594)	2,712,638	0.66%
* Dodge & Cox Int Stock Fnd	1,446,790	93,011	31,282	14,924	(369,151)	1,216,856	0.29%
* Growth Fund of America	12,999,908	1,454,795	725,007	11,663	(397,185)	14,794,188	3.57%
* Capital World Grth & Inc	5,733,326	421,818	204,120	1,534	(270,114)	6,090,684	1.47%
* Vanguard Small Cap Index Fd AS	3,695,463	520,711	104,220	30,807	(65,174)	4,286,027	1.04%
* Vanguard Ext Mkt Idx Inst	16,556,142	769,048	308,990	47,487	(1,119,204)	16,562,463	4.00%
* Vanguard Wlsly Inc Adml	6,883,106	1,011,344	798,427	8,599	707,092	9,408,568	2.27%
* Vanguard Strategic Equity	5,702,908	448,352	(20,444)	1,806	(342,278)	5,790,344	1.40%
Total Equity	148,959,404	8,031,038	9,468,874	273,584	(9,908,873)	156,824,027	37.90%
Total Investments	376,128,769	32,024,037	22,447,907	650,959	(18,443,277)	412,808,395	99.75%
Other Net Assets	1,715,696	(692,688)	(6,413)	-	-	1,016,595	0.25%
Total plan assets	\$ 377,844,465	\$ 31,331,349	\$ 22,441,494	\$ 650,959	\$ (18,443,277)	\$ 413,824,990	100.00%

Investments in bold represent investments exceeding 5 percent or more of net position as of June 30, 2019. Investments with an asterisk (*) represent investments with international mutual funds.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

Risks and Uncertainties

The Plan invests in various investment securities. These securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of fiduciary net position. Since all investments are participant directed, all risks exist at the participant level. Each individual within the plan has the responsibility for managing their exposure to fair value loss.

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The portfolios of the SDRS Supplemental Retirement Plan are benchmarked to the duration of the International Index and must fall between 70 percent and 130 percent of the duration.

As of June 30, 2019, the plan had the following investments and maturities in its fixed income investment and certain mutual funds which include investments in bonds. The durations of the various investment types are listed in the following table:

Fixed Income	Fair Value	Ave Credit Quality	Ave Eff Maturity
Vanguard Total Bond Market Index	\$ 13,685,563	AA	8.20
Balanced			
Vanguard InstTrgRtrmInc Inst	\$ 6,478,574	AA	7.22
Vanguard InstTrgRtrm2015 Inst	10,674,576	AA	7.37
Vanguard InstTrgRtrm2020 Inst	16,260,283	AA	7.83
Vanguard InstTrgRtrm2025 Inst	11,789,048	A	8.62
Vanguard InstTrgRtrm2030 Inst	6,697,969	A	8.62
Vanguard InstTrgRtrm2035 Inst	3,083,813	A	8.62
Vanguard InstTrgRtrm2040 Inst	1,712,002	A	8.63
Vanguard InstTrgRtrm2045 Inst	1,069,274	A	8.62
Vanguard InstTrgRtrm2050 Inst	1,033,730	A	8.62
Vanguard InstTrgRtrm2055 Inst	506,964	A	8.63
Vanguard InstTrgRtrm2060 Inst	133,158	A	7.22
Vanguard InstTrgRtrm2065 Inst	12	Not rated	8.66
	\$ 73,124,966		

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2019, the portfolios held the following investments, excluding those issued by or explicitly guaranteed by the U.S. government, which are not considered to have credit risk. The investments are grouped as rated by Moody's Investors Service.

	<u>Fair value</u>
Moody's rating:	
Aa	\$ 47,098,996
A	31,477,282
Unrated	<u>61,992</u>
Total	<u>\$ 78,638,270</u>

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the plan's investment in a single issuer. The plan's investments are managed by several fund managers. The concentration of investments are determined by the participants' elections to invest in available investments options as selected by the SD Investment Council. The investments that exceed 5 percent are identified in bold on page 51.

(d) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates could adversely affect the fair value of the investment. The plan allows the option of investments in mutual funds of countries outside the U.S. that invest in securities not required to disclose the individual assets within the fund. The fair value of these investments was \$101,403,853 as of June 30, 2019. International mutual funds are marked with asterisk on page 51.

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

(5) Federal Income Tax Status

The Plan is an eligible nonqualified deferred compensation plan under Section 457(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated September 15, 1988. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SUPPLEMENTAL RETIREMENT PLAN

Notes to Financial Statements

June 30, 2019

(6) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement System Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants continue to be 100 percent vested in their account balances.



Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System Supplemental Retirement Plan (SRP), as of and for the year ended June 30, 2019, and the related notes to the financial statements, and have issued our report thereon dated November 6, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SRP's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SRP's internal control. Accordingly, we do not express an opinion on the effectiveness of the SRP's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SRP's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Boise, Idaho
November 6, 2019



Financial Statements
June 30, 2019

South Dakota Retirement System Special Pay Plan



Independent Auditor's Report

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of the South Dakota Retirement System Special Pay Plan (SPP or the Plan), which comprise the statement of fiduciary net position as of June 30, 2019, and the related statement of changes in fiduciary net position, for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective statement of fiduciary net position of the South Dakota Retirement System Special Pay Plan, as of June 30, 2019, and the respective statement of changes in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 59-62 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2019, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Plan's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Plan's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Boise, Idaho
November 6, 2019

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2019

This section presents management's discussion and analysis of the South Dakota Retirement System Special Pay Plan's (SPP or the Plan) financial position and performance for the year ended June 30, 2019. This section is intended to supplement the SPP financial statements and notes.

Financial Highlights

- The net position available for plan benefits of the SPP increased by \$4.9 million during fiscal year 2019. This increase was primarily attributable to additional participant contributions and investment gains.
- The SPP paid \$6.3 million to benefit recipients in fiscal year 2019 compared to \$5.8 million in 2018. The SPP received \$10.1 million in contributions in fiscal year 2019 compared to \$8.8 million in 2018.

Overview of the Financial Statements and Accompanying Information

The basic financial statements consist of:

Financial Statements

The Plan presents the statement of fiduciary net position as of June 30, 2019, and the statement of changes in fiduciary net position for the year then ended. These statements reflect resources available for the payment of benefits as of year-end and sources and uses of those funds during the year.

Notes to Financial Statements

The notes to financial statements are an integral part of the financial statements and provide additional detailed information and schedules.

Financial Analysis

The SPP was established in accordance with Internal Revenue Code Section 401 and under the administrative responsibility of the South Dakota Retirement System Board of Trustees. The Plan is funded by participant contributions and investment income. Marketing and record-keeping services for the Plan are provided by Nationwide Retirement Solutions, Inc.

SPP benefits are based on the participant balances in the Plan.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2019

A summary of the net position held in trust for plan benefits is shown below:

Summary of Fiduciary Net Position June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Assets:		
Investments, at fair value	\$ 58,643,373	\$ 54,203,179
Cash	25,940	774,481
Revenue sharing receivable	54,588	56,282
Accrued interest	523	345
Contributions receivable	<u>2,156,631</u>	<u>911,734</u>
Total assets	60,881,055	55,946,021
Liabilities:		
Accounts payable	<u>8,685</u>	<u>11,231</u>
Net position held in trust for plan benefits	<u><u>\$ 60,872,370</u></u>	<u><u>\$ 55,934,790</u></u>

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management's Discussion and Analysis

June 30, 2019

Changes in Fiduciary Net Position

Additions to the net position mainly were due to contributions during the year. Deductions from net position are primarily benefit payments and administrative expenses. During 2019, SPP paid \$6.3 million to benefit recipients, or 9.22 percent more than 2018.

A summary of the changes in fiduciary net position is shown below:

	2019	2018	Percentage Change
Additions:			
Contributions-employee	\$ 10,111,260	\$ 8,803,043	14.86%
Investment income	1,872,227	1,962,129	-4.58%
Other income	34,650	27,225	27.27%
Total additions	<u>12,018,137</u>	<u>10,792,397</u>	11.36%
Transfers from related plan	<u>2,526</u>	<u>57</u>	4331.58%
Deductions:			
Distributions to participants	6,311,180	5,778,213	9.22%
Administrative expenses	116,723	105,543	10.59%
Revenue Sharing Loss	<u>1,695</u>	<u>3,448</u>	-50.84%
Total deductions	<u>6,429,598</u>	<u>5,887,204</u>	9.21%
Transfers to related plan	<u>653,485</u>	<u>490,703</u>	33.17%
Net change in plan net position	<u>4,937,580</u>	<u>4,414,547</u>	11.85%
Net position held in trust for plan benefits:			
Beginning of year	<u>55,934,790</u>	<u>51,520,243</u>	8.57%
End of year	<u>\$ 60,872,370</u>	<u>\$ 55,934,790</u>	8.83%

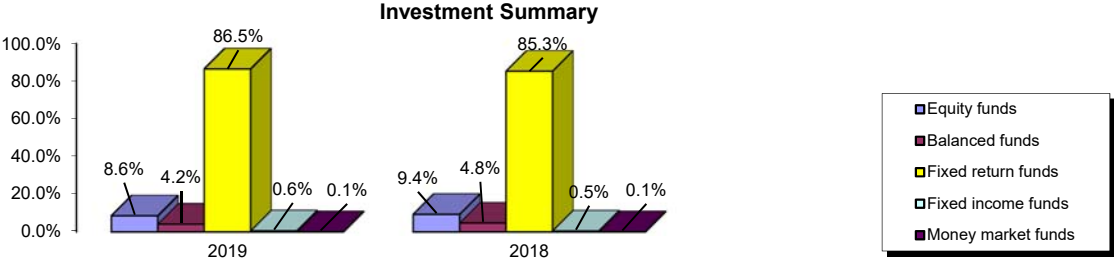
SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Management’s Discussion and Analysis

June 30, 2019

Investments

The selection of SPP investment portfolios alternatives is the statutory responsibility of the South Dakota Investment Officer. The following exhibit indicates the percentage of investment in each of the SPP fund types.



Requests for Information

Requests for information about the SPP may be directed to the Special Pay Plan at 222 East Capitol Ave, Suite 1, Pierre SD 57501. You may reach the SPP at (605) 224-2230 or 1 (800) 959-4457.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Statement of Fiduciary Net Position

June 30, 2019

Assets:

Investments, at fair value:

Equity funds	\$ 5,038,052
Balanced funds	2,434,783
Fixed return funds	50,740,118
Fixed income funds	377,606
Money market funds	<u>52,814</u>

Total investments, at fair value 58,643,373

Cash 25,940

Revenue sharing receivable 54,588

Accrued interest 523

Contributions receivable 2,156,631

Total assets 60,881,055

Liabilities:

Accounts payable 8,685

Net position held in trust for plan benefits \$ 60,872,370

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Statement of Changes in Fiduciary Net Position

Year Ended June 30, 2019

Additions:	
Contributions-employee	\$ 10,111,260
Investment income	1,872,227
Other income	<u>34,650</u>
Total additions	<u>12,018,137</u>
Transfers to related plan	<u>2,526</u>
Deductions:	
Distributions to participants	6,311,180
Administrative expenses	116,723
Revenue sharing loss	<u>1,695</u>
Total deductions	<u>6,429,598</u>
Transfers from related plan	<u>653,485</u>
Net change in plan net position	4,937,580
Net position held in trust for plan benefits:	
Beginning of year	<u>55,934,790</u>
End of year	<u><u>\$ 60,872,370</u></u>

See accompanying notes to financial statements.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2019

(1) Plan Description

The following description of the South Dakota Retirement System Special Pay Plan (the Plan) provides only general information. Participants should refer to the plan provisions for a more complete description of the Plan.

(a) *General*

The Plan was established in July 2004 as a qualified plan pursuant to Internal Revenue Code Section 401(a) under the administrative responsibility of the South Dakota Retirement System Board of Trustees. South Dakota state government and the South Dakota Board of Regents are participating units and every state political subdivision may become a participating unit in the Plan. The Plan consists of 3,122 participants and 134 employers. The Plan mandates that qualifying employees (over age 55 and \$600 or more in special pay) of participating units defer 100 percent of their special lump-sum termination pay to the plan. Special pay is compensation other than regular salary or wages granted to a member of the South Dakota Retirement System and transferred in a sum to the Plan at termination of the member's employment. The participating unit transfers the deferred pay to the fund. This deferred pay is available to a participant immediately after termination, upon later retirement, or to beneficiaries or an estate upon the participant's death.

All amounts of special termination pay deferred under the Plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights held by the fund, at all times until made available to a participant or the participant's beneficiary for estate, shall be held in trust for the exclusive benefit of the participant.

(b) *Contributions*

Participants in the Plan can contribute the lesser of 100 percent of their one-time, lump-sum special pay associated with their termination or \$55,000 for calendar year 2019.

(c) *Participant's Account*

Each participant's account is credited with the participant's contribution, an allocation of the investment earnings or losses, and administrative expenses. Allocations are made based on the participant's percentage of the total investment balance. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account.

(d) *Distribution to Participants*

Distributions of benefits to participants can be made immediately after the participant's termination, or upon the participant's retirement, or to a beneficiary or an estate upon the participant's death. Distributions are in the form of a lump-sum payment in cash equal to the value of the funds allocated to their account or in the form of installments as defined in the plan agreement.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2019

(e) *Risks and Uncertainties*

The Plan invests in various investment securities. These securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of fiduciary net position.

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting*

The accompanying financial statements are prepared using the accrual basis of accounting. Revenue is recorded when earned and expenses recorded when incurred. Employee contributions are recognized when due pursuant to formal commitment, as well as statutory requirements. Distributions to participants are recognized when paid in accordance with the terms of the Plan.

(b) *Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the plan administrator to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(3) Investments

Investments are reported at fair value, in accordance with GASB Statement No. 72. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 sets forth the framework for measuring value. The framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. The three levels of the fair value hierarchy under GASB 72 are described as follows:

Level 1 – Valuation inputs are quoted prices in active markets for identical asset or liability as of the measurement date.

Level 2 – Valuation inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – Valuation inputs are based on significant unobservable inputs for an asset or liability.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2019

As a practical expedient, GASB 72 allows the net asset value (NAV) or its equivalent to be used when a readily determinable fair value is not available. The NAV valuations are based on valuations of the underlying companies as determined and reported by the fund manager or general partner and are excluded from the fair value hierarchy.

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mutual funds	\$ 7,903,255	\$ 7,903,255	\$ -	\$ -
Fixed income funds	50,740,118	-	-	50,740,118
Investments at fair value	<u>\$ 58,643,373</u>	<u>\$ 7,903,255</u>	<u>\$ -</u>	<u>\$ 50,740,118</u>

Fair value for the mutual funds is determined based on the value of the underlying assets in the portfolio. Fixed return funds are carried at contract value, which approximates fair value.

Money market funds invest in short-term, interest-bearing instruments consisting of Treasury Bills, certificates of deposit, and commercial paper. Fixed income funds invest in interest-bearing instruments with varying maturities, including government or corporate bonds, notes, bills, and debentures. Equity funds invest in common and preferred stock and convertible securities of United States and foreign corporations. Balanced funds are invested in a combination of short-term, fixed income, and equity instruments. Fixed return funds are invested in an insurance company group annuity.

The interest rate on fixed return funds is set each quarter and guaranteed for up to two years. These funds are subject to certain restrictions. No more than 20 percent of the beginning of the year aggregate fixed return fund balance may be transferred annually to another investment alternative.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

Investments denominated in foreign currencies are translated into USD using the year-end spot foreign currency exchange rates. Foreign exchange rate gains and losses are included with the net appreciation in fairvalue of investments.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2019

Changes in fiduciary net position for the year ended June 30, 2019 by investment alternatives available to participants were as follows:

	Beginning Balance	Contributions	Investment Income	Transfers In/Out	Additions/ Deductions	Ending Balance	Fair Value as a Percentage of Plan Assets
Money Market							
Vanguard Federal	\$ 52,690	\$ -	\$ 1,328	\$ (12,284)	\$ 11,080	\$ 52,814	0.09%
Fixed Return:							
Prudential	46,218,499	9,508,820	1,410,044	(330,769)	(6,066,476)	50,740,118	83.35%
Fixed Income							
Vanguard Bond Market	275,329	3,334	25,914	-	73,029	377,606	0.62%
Balanced							
Vngrd InstTrgtRtrmInc Inst	682,433	25,013	45,757	-	(21,554)	731,649	1.20%
Vngrd InstTrgRtrm2015 Inst	1,236,348	-	3,035	(65,851)	(733,974)	439,558	0.72%
Vngrd InstTrgRtrm2020 Inst	251,475	-	93,427	-	531,878	876,780	1.44%
Vngrd InstTrgRtrm2025 Inst	244,627	45,299	11,578	-	(88,100)	213,404	0.35%
Vngrd InstTrgRtrm2030 Inst	60,068	-	3,874	-	(106)	63,836	0.10%
Vngrd InstTrgRtrm2035 Inst	30,387	-	1,847	-	(1,195)	31,039	0.05%
Vngrd InstTrgRtrm2040 Inst	12,458	5,723	1,073	-	(21)	19,233	0.03%
Vngrd InstTrgRtrm2050 Inst	48,462	-	2,780	-	(957)	50,285	0.08%
Vngrd InstTrgRtrm2060 Inst	8,508	-	505	-	(14)	8,999	0.01%
Total Balanced	2,574,766	76,035	163,876	(65,851)	(314,043)	2,434,783	4.00%
Equity							
Dodge and Cox Int Stock Fd	40,428	-	478	-	8,661	49,567	0.08%
DodgeCox Global Stock	143,511	-	(99)	(5,863)	(14,030)	123,519	0.20%
Am Funds Capital World Grth &	245,256	-	3,117	-	(108,040)	140,333	0.23%
Vanguard Ext Mkt Ind Inst	727,728	-	11,802	(55,978)	44,668	728,220	1.20%
Growth Fund of America	921,225	3,333	44,718	(11,420)	16,651	974,507	1.60%
Mutual Shares	286,103	-	(18,895)	(8,007)	(259,201)	-	0.00%
Windsor II Admiral	412,891	-	29,366	-	(4,472)	437,785	0.72%
Vanguard Small Cap Indx Fd AS	206,734	-	7,268	(6,259)	116,593	324,336	0.53%
Vanguard Instit Index	1,099,567	20,438	139,094	(144,398)	187,509	1,302,210	2.14%
Vanguard Tot Intl Stock Ind	283,518	-	748	(5,481)	(83,275)	195,510	0.32%
Vanguard Wlsly Inc Adml	524,904	-	50,054	(4,649)	(47,609)	522,700	0.86%
Vngrd Gr Indx Adml	-	-	2,246	-	37,156	39,402	0.06%
Vngrd Val Indx Adml	-	-	794	-	3,091	3,885	0.01%
Vanguard Strategic Equity	190,030	3,334	(149)	-	2,863	196,078	0.32%
Total Equity	5,081,895	27,105	270,542	(242,055)	(99,435)	5,038,052	8.28%
Total Investments	54,203,179	9,615,294	1,871,704	(650,959)	(6,395,845)	58,643,373	96.34%
Other Assets	1,731,611	495,966	(1,172)	-	2,592	2,228,997	3.66%
Net position held in trust for plan	\$ 55,934,790	\$ 10,111,260	\$ 1,870,532	\$ (650,959)	\$ (6,393,253)	\$ 60,872,370	100.00%

Investments in bold represent investments exceeding 5 percent or more of net position as of June 30, 2019.

SOUTH DAKOTA RETIREMENT SYSTEM SPECIAL PAY PLAN

Notes to Financial Statements

June 30, 2019

(4) Plan Administration

Nationwide Retirement Solutions, Inc. (NRS) of Columbus, Ohio, is the private sector administrator and marketing agent of the Plan. NRS provides various accounting, reporting, and marketing services and receives compensation through maintenance and asset fees charged against each participant account.

(5) Federal Income Tax Status

The Plan is a qualified plan under Section 401(a) of the Internal Revenue Code and is exempt from federal income taxes. The Plan has received a favorable determination letter dated October 28, 2004. The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

(6) Plan Termination

Although they have not expressed any intent to do so, the South Dakota Retirement System Board of Trustees and the South Dakota Legislature have the right to terminate the Plan. In the event of plan termination, participants would continue to be 100 percent vested in their account balances.



Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees
South Dakota Retirement System
Pierre, South Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South Dakota Retirement System Special Pay Plan (SPP), as of and for the year ended June 30, 2019, and the related notes to the financial statements, and have issued our report thereon dated November 6, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered SPP’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SPP’s internal control. Accordingly, we do not express an opinion on the effectiveness of the SPP’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SPP’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the

determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Eide Bailly LLP". The signature is written in a cursive, flowing style.

Boise, Idaho
November 6, 2019